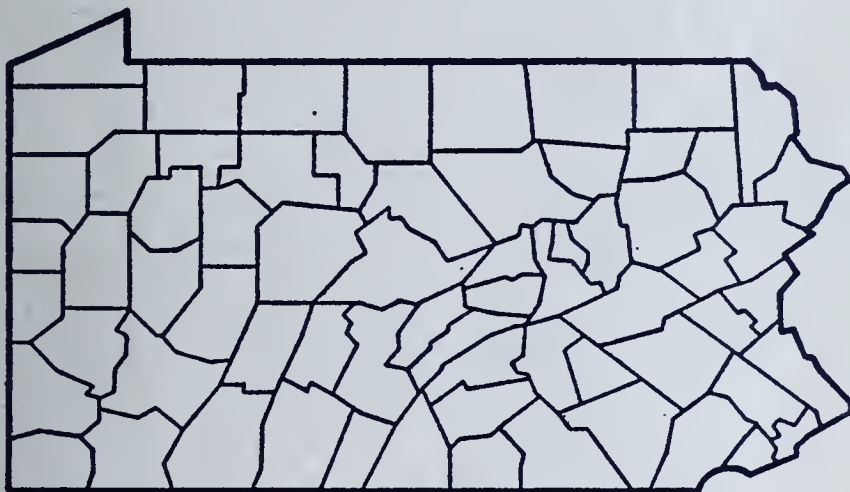


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LETTER OF TRANSMITTAL
COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA POST-WAR PLANNING COMMISSION
HARRISBURG, PENNSYLVANIA

March 15, 1945.

THE HONORABLE EDWARD MARTIN,
Governor of Pennsylvania,
Harrisburg, Pennsylvania.

DEAR GOVERNOR MARTIN:

The Post-War Planning Commission presents the following report on Pennsylvania State Fiscal Policy and Taxation. Its objective is to examine the position which the State now holds in the governmental fiscal scheme and appraise the situation which will likely exist in the post-war years.

The program was developed under the direction of the Honorable Charlie R. Barber, Mayor of Erie and a member of this Commission, and the Honorable Edward B. Logan, Budget Secretary. Very valuable assistance was furnished during the course of the survey by the Honorable David W. Harris and Mr. Harold C. Sheets, of the Department of Revenue, and the Honorable William S. Livengood, Jr., and Mrs. Sara A. Behman, of the Department of Internal Affairs.

The members of the Commission extend their sincere thanks to all who have so generously given time and effort to the preparation of this report.

Respectfully submitted,

H. W. PRENTIS, JR.,

Chairman.

Introduction . . .

From the standpoint of fiscal policy and taxation the post-war situation in which the states find themselves will differ greatly from the pre-war situation. Due to the tremendous increase in demand for funds by the Federal Government the competition for tax sources, already keen before the war, will be greatly intensified. This imposes upon the states the necessity of keeping their finances in sound condition, reducing indebtedness, and using any present surplus funds only for preserving and building up permanent values. In evaluating the present State tax system consideration should be given to the effect upon the State's economy which the tax system is producing. Such consideration should be given, also, to any further development of the tax system.

STATE FISCAL POLICY AND TAXATION

FISCAL POLICY

GENERAL OUTLOOK

In approaching this project of State fiscal policy and taxation, it is of interest to examine the situation in which the State now exists in our governmental scheme and in which it will likely exist in the post-war years.

At the present time the State is in a situation which differs very greatly from that which it occupied in pre-war years, and in all probability that situation will remain somewhat the same after the war. At the present time Federal taxes and expenditures far exceed State taxes and expenditures. In 1943 Federal tax collections amounted to \$22,168,190,837.¹ Tax collections of all the States were \$5,094,263,000.² Federal expenditures during 1943 were \$78,182,349,000³ while the expenditures of all States amounted to \$5,892,143,000.⁴ As far as the Federal Government is concerned, this, of course, is an abnormal situation at the present time, but it appears that Federal expenditures in the post-war years may amount to \$18,000,000,000 or \$20,000,000,000 and Federal taxes, unless the Federal debt is to be increased, will have to balance that amount.

While State expenditures may increase somewhat in post-war years, that increase in all probability will be small.

It is of interest to see the trend in the changing position of the States in the governmental scheme. The share of the Federal Government in total tax collections increased from 27.1 per cent in 1915 to 32.7 per cent in 1930, to 42.9 per cent in 1941 and to 69 per cent in 1943.

The corresponding percentages for state governments for these years were as follows:

1915	15.9%
1930	19.9%
1941	27.7%
1943	15.8%

¹ U. S. Treasury Report for 1943.

² Bureau of Census, "State Finances, 1943".

³ U. S. Treasury Report for 1943.

⁴ Bureau of Census, "State Finances, 1943".

The percentages for local governments for these years were as follows:

1915	57.0%
1930	47.4%
1941	29.4%
1943	15.2%

The appearance is then that during the post-war years we will find the States operating in a situation where the Federal Government is collecting about \$20,000,000,000 of taxes a year, local governments collecting about \$4,500,000,000 and state governments collecting about \$5,000,000,000. This is going to mean that the competition for tax sources which was a keen rivalry before the war will become a greatly intensified situation. Before the war we found both State and Federal levies in force for both corporation and personal income taxes, death taxes, and stock transfer taxes. Also, we found both the Federal Government and the States taxing tobacco, motor fuel, alcoholic beverages and payrolls. It has been estimated that three-fourths of State revenues and an even larger proportion of Federal revenues come from these overlapping sources. The only important independent State taxes remaining are the general sales taxes, special corporation taxes and the general property tax. And of these, the general property tax has been very largely turned over to local governments.

Because of this competition for tax sources which is now very pronounced and which it seems certain will continue to be very keen in the post-war years, the State should support any well founded movement designed to secure a better allocation of tax sources among the different levels of government. The States' representatives in Congress and in the United States Senate should be urged to promote a program to secure a better allocation of tax sources.

FUNDS AVAILABLE FOR POST-WAR WORK

In discussing funds available for post-war work it is necessary to recognize that there are different State funds in which available funds exist. It now appears that at the end of the 1943-1945 biennium there will be a General Fund surplus of at least \$110,000,000.

One of the important questions of fiscal policy arises in connection with this large surplus. To what extent should this surplus be used for post-war public works?

METHODS OF DEALING WITH SURPLUS FUNDS

There are several alternatives in dealing with a surplus, any one of which, or a combination of which, might be adopted. The alternatives which might be mentioned are: tax reduction, debt reduction, expenditure for public works and setting aside as a reserve fund. Each of these alternatives needs examination.

Tax Reduction

At the beginning of the 1943-1945 biennium, \$23,319,000 of this estimated surplus of \$110,000,000 was on hand. \$76,681,000 of this surplus will be due to the receipts from the present biennium although about \$14,000,000 of this amount was derived from taxes repealed at the 1943 Session of the Legislature, but collected for some part of the present biennium.

The receipts of the present biennium result from an abnormal situation, and therefore, in considering tax reduction, it appears that we need to use as a base a biennium which does not have the inflated receipts and the greatly decreased expenditures which exist in the present biennium. It appears that a more normal biennium was that of 1941-1943. This biennium began on June 1, 1941. This was shortly after the beginning of the lend-lease policy on the part of the Federal Government and not a great deal of expansion had come before that time. The receipts of that biennium from the corporate taxes were those for the calendar years 1941 and 1942. While there had been some expansion by the end of 1941, the increase was not excessive and the considerable increase in the calendar year 1942 does not seem to be far out of line with what might be anticipated in post-war years.

During the 1941-1943 biennium total General Fund receipts amounted to \$456,000,000 but since that time taxes have been repealed which during that biennium produced \$67,000,000.⁵ The amount involved in the exemption of manufacturers from the capital stock tax which becomes effective at the end of the

⁵ Manufacturers Exemptions	\$24,000,000
Emergency State Personal Property Tax	22,300,000
Emergency Bank & Trust Company Shares	6,000,000
Emergency Corporate Loans	5,500,000
Retail and Wholesale Mercantile Abolished	6,967,300
Gross Receipts—reduced 6 mills	3,120,000
	<u>\$67,887,300</u>

war is included in that amount. Therefore, the tax structure without the taxes which were repealed yielded \$389,000,000 during the 1941-1943 biennium.

Since the 1941-1943 biennium a change has been made in the corporate net income tax which has strengthened the revenue structure. A change was made which disallows Federal taxes as a deduction in computing the corporate net income tax and as a result we can expect that tax to produce about thirty per cent (30%) more revenue. The yield from that tax in 1941-1943 was \$90,620,944 and with thirty per cent (30%) increase, that tax would have yielded \$27,000,000 more, or a total of \$117,807,227 in 1941-1943. Therefore, this amount can be added to the \$389,000,000 which was realized in that biennium, making a total of \$416,000,000. Due to the provisions on renegotiation of contracts and carry back-carry forward of losses in the Federal Revenue Act it would seem advisable to allow a margin for those contingencies of about \$25,000,000. An estimate of about \$390,000,000 would seem more likely.

During 1943-1945 appropriations amounted to \$373,000,000. But in that amount was an appropriation of \$24,000,000 for increasing teachers' salaries and \$9,000,000 for construction. Without these appropriations the total was \$340,000,000. It appears that with high costs continuing the Legislature will feel compelled to provide again the amount for increased teachers' salaries. During this biennium \$89,000,000 was appropriated for Public Assistance. This was \$126,000,000 less than was appropriated for Public Assistance at its peak period in 1939-1941. But it seems reasonable to use a base far below that of the peak amount. For the 1945-1947 biennium it appears the Department of Public Assistance will request an amount similar to that in the present biennium.

It appears then that appropriations without provision for public works would run between \$367,000,000 and \$377,000,000 for the next biennium. Taking the middle point between these two, \$372,000,000 leaves a spread of \$18,000,000 between appropriations and expected receipts under our existing tax structure. There would be that amount added to the present surplus reduced by whatever amount appropriations might exceed \$372,000,000.

It is apparent then that there is not a very large spread be-

tween the current expenditures of the State Government supported from the General Fund and the receipts under the existing tax structures. It appears that there could not be very much tax reduction in General Fund taxes without current expenditures falling below current receipts.

Debt Reduction

The total State bonded indebtedness at the present time amounts to \$57,219,679. Of this amount, \$26,826,956 is invested in Veterans Compensation bonds and will be retired from the General Fund, and \$30,392,723 represents highway bonds which will be retired from the Motor License Fund. In addition to this bonded indebtedness there is outstanding \$48,870,000 of the General State Authority bonds which are being retired over a thirty-year period by the State through the method of paying rentals for public works constructed.

In considering the question whether the bonded indebtedness or some part of the bonded indebtedness should be retired from surplus funds, it is necessary to examine the nature of the State's indebtedness. The Veterans Compensation bonds and the highway bonds are non-callable bonds and therefore appear to be beyond redemption except in accordance with the terms in the bonds.

The indebtedness of the General State Authority which, after all, is an obligation of the State, needs consideration. As was stated, \$48,870,000 of these bonds are now outstanding. They bear interest at 4 per cent. The whole amount of these bonds outstanding are owned by the retirement funds. While 4 per cent is an abnormal rate of interest to be paid, it is argued that the retirement funds receive these earnings and that without such earnings they would fall short of earning the amount which the State guarantees. In other words, it is argued that if these retirement funds did not receive 4 per cent interest on these investments, the State would have to supply the deficiency under its guarantee to do so when earnings fall below 4 per cent. It would appear, however, that this argument is not sound. If these bonds were full faith and credit bonds, the rate of interest would be less than half of what it now is and it would seem to be better for the State to appropriate directly for any shortage that might arise in the earnings of the retirement funds. For these funds to receive this high

rate of interest tends to take away the incentive for them to maintain their earnings on other investments. Moreover, because of the State Authority arrangement under which the State leases the buildings from the State Authority, many inconveniences arise which are a source of annoyance to the departments having charge of the functions for which these buildings are used. For these reasons there appears to be a good case for using some of the surplus to pay off the General State Authority bonds.

If all were paid off, \$48,870,000 of the surplus would be required. There would be an item of approximately \$8,000,000 now appropriated biennially for rentals eliminated from the biennial State budget. This would further increase the spread between receipts and expenditures referred to above in the discussion of tax reduction.

At this point the manner in which the State creates indebtedness should be examined.

The power of the State to borrow is strictly limited by the Constitution. The Constitution provides that "no debt shall be created by or on behalf of the State, except to supply casual deficiencies of revenue, repel invasion, suppress insurrection, defend the State in war, or to pay existing debt; and the debt created to supply deficiencies in revenue shall never exceed in the aggregate, at any one time, one million dollars."⁶ To borrow money beyond this constitutional restriction a constitutional amendment is required. There have been some occasions when it was found desirable to borrow. This has been done by constitutional amendment for construction of highways, veterans bonus, toll bridges, and one loan for general purposes. Public works, outside of highways, have always been undertaken from current funds.

The question is whether the borrowing power of the State is too strictly limited. In most other states we find the borrowing power as strictly limited as it is in this State. There are some, however, Indiana, Massachusetts, New York and Virginia, which have established no maximum limit provided in the Constitution. The legislatures of those states are free to borrow in whatever amount they decide.

In Pennsylvania there is a time lag of more than two years before borrowing can be undertaken in that the resolution for a constitutional amendment must be passed by two sessions

⁶ Constitution of Pennsylvania—Article IX, Section 4.

of the legislature and then voted upon at an election. It appears that this is too slow. If Pennsylvania is to provide for some of the public works and other abnormal expenditures by borrowing, this time lag may be too great, especially is this true in times of economic emergencies. Moreover, there appears to be a rather convincing argument for using the borrowing power for unusual expenditures in order to cause as little disturbance to the tax structure as possible. Increases or decreases in taxes change the relative competition position of commodities and causes economic dislocations and inequities. It seems that it would be advisable for the legislature to consider changing the provisions in the Constitution with respect to borrowing—either to increase the amount which may be borrowed by the legislature or to shorten the period necessary for borrowing, or perhaps both. In considering this borrowing provision, full consideration should be given to the method now in existence in some states where there is no maximum limit.

Public Works

Since the spread between the yield from the present tax structure and current expenditures in the General Fund in a normal year is small, post-war public works supported from the General Fund, it appears, will have to come from surplus funds now on hand to be supplemented by whatever General Fund current receipts can be made available for public works. If, as we recommend, the General State Authority bonds should be retired, the remaining surplus funds on hand would amount to \$61,000,000.

Some idea of the extent to which surplus funds now on hand may be supplemented by current funds for post-war public works can be obtained from the following table:

EXPENDITURES FOR PUBLIC WORKS IN PENNSYLVANIA 1921-1923 TO 1943-1945

<i>Year</i>	<i>General Fund</i>	<i>Motor License Fund</i>	<i>Total</i>
1943-1945	\$12,872,900	\$27,833,500*	\$40,706,400
1941-1943	9,156,318	77,564,992	86,721,310
1939-1941	6,549,812	44,285,394	50,835,206
1937-1939	12,352,702	46,267,517	58,620,219
1935-1937	1,639,463	21,264,643	22,904,106
1933-1935	744,894	55,251,863	55,996,757

EXPENDITURES FOR PUBLIC WORKS IN PENNSYLVANIA

—Continued

1921-1923 TO 1943-1945

<i>Year</i>	<i>General Fund</i>	<i>Motor</i>		<i>Total</i>
		<i>License Fund</i>		
1931-1933	10,982,873	68,290,575		79,273,448
1929-1931	28,670,251	97,550,033		126,220,284
1927-1929	14,911,900	35,995,185†		50,907,085
1925-1927	7,158,325	114,969,396†		122,127,721
1923-1925	2,838,298	64,034,291†		66,872,589
1921-1923	4,426,823	79,213,605		83,640,428

* Governor's Estimate.

† Includes Road Bonds.

Sources: Biennial Budgets of the Commonwealth.
Department of Highway Statements—1921-1925.

In the General Fund it appears that while the amount varies from year to year it would approximate \$10,000,000 for a two-year period.

Post-war public works on the highway system would be supported from the Motor License Fund. At the end of the present biennium there will be surplus funds of about \$55,000,000. All of this amount would be available for highway construction. Post-war highway work beyond that amount would have to be derived from current Motor License Fund revenues and that amount would be substantial—approximating \$45,000,000 in a normal two-year period.

In considering public works in relation to surplus funds, there are some fundamental policies which should be followed. The first is that State funds should be expended only for essential public works. State funds should not be used for public works to create employment, stimulate business activity, or for any other purpose unless the projects are essential.

Secondly, it would be good policy for the State in expending funds for necessary public works to co-ordinate that program with the business cycle as much as possible. During an upswing of the cycle, the program should be reduced to a minimum and increased during depressed business conditions. By this policy, employment can be furnished when badly needed, materials and labor costs will be less, and the State will not be contributing to runaway inflationary booms.

This will be a reversal of the policy followed by the states and local governments heretofore. In the seven years ending in 1930 the net long-term borrowings of states and local governments averaged about a billion dollars per year. In 1932 the borrowings of states and local governments dropped to \$200,000,000 and in 1933 such borrowings practically disappeared. At the time when employment was badly needed, the states had no surplus funds for public works and had to use all current funds that could be obtained for providing relief. In Pennsylvania, expenditures for public works for the past twenty years were as shown in the preceding table.

An examination of the table shows that the practice pointed out for other states has been carried on in Pennsylvania. The lean years in expenditures for public works for the most part were the years when heavy expenditures were needed. The heaviest expenditures were in more prosperous years.

But although the State attempts to follow the policies mentioned above there will be projects which because of their urgency must be undertaken regardless of the business cycle. The various State departments have planned public works programs which in total considerably exceed surplus funds anticipated at the end of the present biennium. Some of these projects are urgent and to the extent that they are surplus funds should be used in the next biennium for such projects. Others planned by the departments should be delayed until the post-war employment situation can better be known. Although due to the great uncertainty ahead in the post-war period it seems that the appropriations should be established for necessary public works at the 1945 Session of the Legislature to be available if an acute unemployment situation should develop.

RESERVE FUND

Still another alternative in considering the disposal of the surplus is that of placing the funds in a reserve with appropriations to be made by future sessions of the Legislature. In Pennsylvania, the Legislature regularly meets every two years. There could be no legislative actions in setting up appropriations against the reserve fund short of that time unless a Special Session of the Legislature should be called. With future conditions as uncertain as they are, it seems that a two-year period of time might be too long from the standpoint of making

funds available for necessary public works to help meet an acute unemployment situation, should it arise. It seems better policy to establish these appropriations at the forthcoming Session for necessary public works and to develop the program excepting urgent projects in correlation with existing economic conditions.

DISTRIBUTION OF STATE FUNDS AMONG VARIOUS FUNCTIONS

There are a number of classifications of State appropriations which might be used to show the distribution of State funds. A useful classification is that showing State expenditures by broad functions. The table on page 17 shows such a classification of State expenditures yearly since the fiscal year 1931-1932.

This table shows that in Protection to Persons and Property, General Government, Conservation of Natural Resources, and Highways, expenditures have remained fairly constant since 1931. Although there has been a \$100,000,000 increase in total expenditures during the period shown here, practically all of this increase has been for Public Health and Welfare and Public Education. In these two functions there was an increase of \$98,000,000 from 1931-1932 to 1943-1944.

It appears that in the post-war years the trends we see in this period will continue. There is no reason for believing that the functions for which expenditures have remained fairly constant during this period will not continue fairly constant in the post-war years with possibly the exception of the Department of Highways. With the release of wartime controls expenditures by the Department of Highways will no doubt increase in view of the backlog of road work which has accumulated during the war period.

In the fiscal year 1943-1944, 82 per cent of total State expenditures was made for three functions: Public Health and Welfare, Public Education, and Highways. It appears that this condition will continue in the post-war years and it is likely that this percentage will increase beyond the percentage in 1943-1944.

In the fiscal year 1939-1940, when public assistance demands were high, and the Department of Highways was making expenditures at a higher figure, these three functions consumed eighty-four per cent of total State expenditures.

DISTRIBUTION OF STATE FUNDS AMONG VARIOUS FUNCTIONS
1931-1932 TO 1943-1944

<i>Fiscal Year</i>	<i>Protec- tion to Persons and Property</i>	<i>General Govern- ment</i>	<i>Conserva- tion of Natural Resources</i>	<i>Public Health and Welfare</i>	<i>Public Education</i>	<i>Highways</i>	<i>Fixed Charges Interest and Sinking Fund</i>	<i>General State Authority Rentals</i>	<i>Total</i>
1931-1932 ..	\$12,749,272	\$10,863,078	\$3,984,294	\$29,494,198	\$48,934,490	\$56,559,243	\$6,966,817	\$	\$169,551,395
1932-1933 ..	12,224,838	9,669,224	3,906,278	45,696,090	43,089,535	51,988,584	5,312,148		171,886,700
1933-1934 ..	11,324,561	8,271,122	3,551,979	58,067,508	46,481,250	49,996,328	1,285,447		184,978,198
1934-1935 ..	11,464,924	8,680,781	2,718,441	45,920,978	47,238,790	77,265,289	9,854,023		203,143,246
1935-1936 ..	11,770,487	9,006,216	2,562,681	100,762,122	43,091,133	41,578,774	14,163,006		222,934,422
1936-1937 ..	12,067,761	11,200,100	2,914,438	112,031,831	49,482,259	69,417,419	14,665,984		271,779,795
1937-1938 ..	14,754,060	13,886,789	3,823,707	128,906,911	49,077,938	82,432,738	14,088,605		306,970,751
1938-1939 ..	16,736,056	14,605,432	3,709,989	154,955,351	49,691,701	78,106,941	10,892,211	132,459	328,830,145
1939-1940 ..	14,431,391	13,879,450	3,832,905	164,137,390	50,793,669	54,989,344	17,492,810	2,476,942	322,033,904
1940-1941 ..	14,710,820	12,124,136	3,619,330	140,869,375	55,192,343	67,864,595	12,551,615	3,504,376	310,436,593
1941-1942 ..	15,524,458	11,734,069	3,823,440	121,746,907	62,927,698	79,104,016	15,796,904	3,776,882	314,154,377
1942-1943 ..	14,611,262	12,001,051	3,602,116	105,587,652	69,510,807	56,621,117	13,158,661	4,013,985	279,106,654
1943-1944 ..	14,163,804	12,135,699	3,864,721	98,664,835	77,195,058	45,727,521	11,799,547	6,109,653	269,660,841

These three functions consume such a large share of the State budget that they require separate examination here if we are to forecast State expenditures in the post-war years.

Public Health and Welfare

The expenditure for Public Health in this function of Public Health and Welfare is small in comparison with expenditures for Welfare functions. The expenditures for Public Health from State funds from 1931 to 1944 have remained fairly constant, running between \$3,000,000 and \$3,500,000 yearly. There has been considerable expansion in expenditures for Public Health during that period but the expansion which has come about has been by means of the use of Federal funds rather than State funds. The heavy expenditures for the Public Health and Welfare functions have been for Public Assistance and for Welfare institutions. In these two categories there has been a great expansion in the period under review here. The expenditures for Public Assistance were built up to a high point of \$122,623,407.59 in the 1939-1940 fiscal year. Since that time, Public Assistance expenditures dropped to \$43,720,582.22 in the 1943-1944 fiscal year. Expenditures for Public Assistance fall in four different categories: Pensions for the Blind, Aid to Dependent Children, Old Age Assistance and General Assistance. It is the latter category which causes broad fluctuations in the expenditures for Public Assistance. Expenditures in this class rise or fall according to economic conditions in which the State government operates. It is not reasonable to believe that economic conditions which have lowered Public Assistance expenditures from \$122,623,407.59 to \$43,720,582.22 will exist in the post-war years. There is most certainly reason to believe that Public Assistance expenditures will rise with an increase in unemployment. The Department of Public Assistance does not believe that in the next biennial period expenditures will need to exceed those in the present biennium.

State expenditures for maintenance of Welfare institutions have shown a great increase in this period. At the beginning of the period in the fiscal year 1931-1932, \$18,039,022.41 was spent for Welfare institutions. In the fiscal year 1943-1944, \$26,655,139.65 was spent. This increase has come about primarily from two causes: an expansion of institutions which

existed in 1931, and the acquisition of institutions which formerly had been county institutions and twelve county mental hospitals. A considerable share of this increase was a transfer of a burden which had been falling upon the counties to the State government. In the post-war years it appears that expenditures in this field will increase primarily from expansion and development of existing State institutions. These institutions have been the object of study of two committees appointed by the Governor: one for the mental hospitals and one for the penal institutions. The committee which studied the mental institutions came to the conclusion that at the present time we require 5,413 additional beds to meet the present load. In addition to this the committee found that there are approximately 4,000 beds in structures which do not meet safety and hygienic standards. Furthermore, the committee pointed out that the annual increment of new patients in Pennsylvania mental hospitals has totaled 700 per annum over the last ten-year period.

In institutions for the feeble-minded the committee found that we have at the present time an overcrowding of 418 and a waiting list of 3,067. The committee estimated that in order to provide the additional required buildings and the improvement of existing buildings would involve an expenditure of \$115,000,000 over the next ten-year period. The maintenance cost will increase as the population increases. The committee estimates that over a ten-year period the patient population in the mental and feeble-minded institutions will increase 10,500. Assuming an average yearly cost of \$303 per patient, maintenance costs over the ten-year period would rise \$3,181,500.

The committee which made a survey of the penal institutions estimates that our present population will increase from 5,700 to 7,000. To provide facilities for this increase and to make some re-arrangements in our present system of caring for the prison population, will require, the committee states, \$18,000,000 during the period ending January 1, 1947. If the prison population increases as estimated by the committee, the maintenance cost will increase by a considerable amount. Assuming a cost of \$580 per year this maintenance cost would increase \$754,000 annually. In all then we can expect a very considerable increase in State expenditures for Public Health and Welfare in the post-war years.

Public Education

In the field of Public Education expenditures have shown a rapid increase during the last thirteen years. This increase has come about throughout the State assuming a larger share of the total expenditures for Public Education. In 1931-1932 the State was paying 20 per cent of total expenditures in the State for Public Education. In 1943-1944 the State paid 26.2 per cent of total expenditures for Public Education. It seems that this movement for the State to take over a larger and larger share of the cost of Public Education will continue in the post-war years. The pressure for this comes from different sources. One source is from the property tax interests attempting to shift part of the burden which falls upon property taxes to the State. Another source of pressure comes from those who want to raise standards of education through greater State support. A good illustration of the pressure from the second group was seen in the last Session of the Legislature resulting in a grant of \$24,000,000 additional funds by the State for increasing teachers' salaries. An important departure was made in making this grant in that the State assumed the whole burden whereas previously the local districts had shared any such increase in costs. At one step the State assumed a burden which, if the customary sharing process had been used, would not have involved a \$24,000,000 outlay unless the local districts were furnishing \$68,307,692.

To what point does this trend lead? What share of the public education burden should the State eventually assume? These are questions which must be answered if we are to predict expenditures by the State for public education.

A committee established by the Legislature appointed by the Governor has been making a comprehensive survey of the public school system and the substance of the report of that committee appears in the section of this project on Local Government Finance and also in the project on Education. For this report the important consideration is that the additional cost in changing to the system of State grants recommended would be from \$12,000,000 to \$15,000,000.

At this point it is well to observe this relationship between the State and the local governments in considering this subject of public expenditures. The amount the State expends is based to a very large extent upon the degree to which the State as-

sumes functions or the extent to which it helps to finance functions which formerly had been performed and financed by local governments. Especially is that true in these three major functions: Public Health and Welfare, Public Education, and Highways. The increase on the part of the State does not necessarily mean an increase in the total cost of government. It may mean a shifting of the burden from one governmental jurisdiction to another jurisdiction and a shifting of the burden from one set of taxpayers to a different group of taxpayers. Too often there is confusion of thought on this point. Too often a transfer of expenditures from one jurisdiction to another is considered a reduction in expenditures. Viewing this situation broadly, it appears that such transfers should be made only when there is a compelling reason for such a transfer from the standpoint of raising standards or for promoting economic government. It does not seem that transfers for the purpose of shifting from one set of taxpayers to another is good reason for such transfers of functions. Usually it appears that such transfers of functions do not promote economic government but rather increase the total cost.

There are various reasons for this, but one of the outstanding reasons is that when funds are expended by the State in local areas throughout the State there is a tendency towards extravagance since the funds do not come from the local taxpayers among whom the function is performed.

A similar situation arises between the State and the Federal government. A considerable share of the cost of some State functions has been transferred to the Federal Government through the system of grants from the Federal Government. This situation has not been productive of more economical performance of those functions—rather the cost of those functions has been greater than if the State assumed the whole burden.

But there is a consideration from the viewpoint of the local government which needs to be recognized here. While the State expenditures have greatly increased in assuming and financing functions formerly performed and financed locally, it should be recognized that in some situations while State expenditures have increased, local expenditures have increased at the same time. A good illustration of this is found in the highway function. State highway expenditures have greatly increased by means of the State adding roads formerly belonging to counties, cities, and other local units of government to

the State highway system. Yet we find that the expenditures of some of the local governments for road construction and maintenance have greatly increased. For instance, in the City of Erie, expenditures for highways increased from \$20,000 in 1910 to \$305,000 in 1939 and similar increases could be pointed out in the other cities in the State. The demands for improved highways and highway facilities and the attendant increases therefor have increased in cities much more rapidly than the decrease in costs occasioned by the State taking over some of the highways. The State, when its expenditures for highways increased, imposed larger and larger taxes and license fees upon those using the highways in order to meet those increased expenditures. But it should be noted the State did not grant to the cities authority to impose such taxes on those who used the streets of the city to meet the increased demands made upon city government. This has brought about a situation wherein cities have had to throw this burden upon other sources of revenue and has been a large factor in increasing the burden on real estate. It seems that this situation needs the serious consideration of the Legislature. Rather than a further transfer of functions to the State it seems that the Legislature might well consider establishing a more helpful system of sharing motor license revenues by the State and local governments.

Post-War State Expenditures

For the last thirteen years, outside of highways, it appears that the State, due to financial stringency and the war, has not been able to provide the necessary capital facilities and the necessary replacements and repairs. For that reason, the State is now in a situation where a large amount of public works is necessary and should be undertaken as soon as conditions warrant.

The needs of the various departments for public works appear in separate studies in this report. This is going to involve large expenditures during a few years. The recommendation with respect to such a program appears under the separate reports.

The present State surplus is not sufficient to provide for all of the needs. The recommendation has already been made that the present State surplus, outside of the amount sufficient to retire the General State Authority bonds, be set up in appropriations for necessary public works to be expended when the

economic situation justifies. These appropriations should be devoted to the public works which are most urgent from the standpoint of the needs of the people of the State. For those projects for which funds are not sufficient to set up appropriations, it appears that it will be necessary either to finance projects from current funds in future biennia or to borrow. It is for that reason that earlier in this report we recommended that the Legislature give study to the present method of borrowing.

STATE TAXATION

THE PRESENT TAX SYSTEM

The Trend of State Revenues

In beginning the discussion of the subject of State taxation in Pennsylvania it seems in order to see what the present total revenues of the State are and the trend over the last fourteen years. The following table shows the total revenues and shows also the amount of the total which is deposited in the General Fund. The table shows that there has been a very rapid increase in total revenues during this period. Especially was there a great increase after 1935-1936. In the General Fund, receipts in 1943-1944 were nearly three times what they were in 1934-1935.

General Fund receipts in the 1943-1944 fiscal year were \$228,000,000. This amount was 77% of all revenues, but was \$2,000,000 less than the peak in the preceding year. Since the 1936-1937 fiscal year the taxes from the General Fund have comprised over 67% of all revenues and receipts.

The increase in receipts was the result of the emergency taxes levied in 1935-1936 and greatly increased production during the war. In 1934-1935 the tax receipts were only \$79,000,000, or 55% of all revenues. After the enactment of the emergency taxes, the receipts amounted to \$115,000,000. These taxes included sales taxes such as the liquor tax, cigarette tax, and liquid fuels tax, besides such taxes as the corporate net income tax and additional business taxes.

The rise in General Fund receipts since 1930-1931 is very evident since there has been 103% increase since that time, while total revenues and receipts have increased only 54% since that period.

Comparison of Yearly Revenues with Income

It is of interest to compare the yearly receipts for the last fourteen years with the income in the State and to see what percentage of income was being taken by State taxes in each year. The following chart shows such a comparison. From a low of 2.9% in 1934-1935 the share of income taken from taxes rose to 5.2% in 1937-1938. Thereafter the share of income taken for taxes steadily declined until it reached 3% in 1943-1944. It should be observed that while the share taken by

TREND OF REVENUE RELATED TO INCOME
1930-31 TO 1943-44

<i>Year</i>	<i>Total Revenues</i>	<i>General Fund Receipts</i>	<i>% General Fund Receipts Are of the Total Revenues</i>	<i>Pennsylvania Income</i>	<i>% Total Revenues Are of Pa. Income</i>
				(In millions)	
1930-31	\$186,084,000	\$112,702,000	60.6%	\$5,579	3.3%
1931-32	157,385,000	85,314,000	54.2	4,166	3.8
1932-33	157,246,000	93,106,000	59.2	4,012	3.9
1933-34	140,541,000	77,973,000	55.5	4,612	3.1
1934-35	143,538,000	79,221,000	55.2	4,974	2.9
1935-36	193,823,000	114,428,000	59.0	5,808	3.3
1936-37	304,745,000	226,017,000	74.2	6,173	4.9
1937-38	281,526,000	204,557,000	72.7	5,441	5.2
1938-39	255,796,000	176,742,000	69.1	5,819	4.4
1939-40	270,497,000	189,105,000	69.9	6,285	4.3
1940-41	289,827,000	194,012,000	66.9	7,455	3.9
1941-42	309,110,000	217,761,000	70.4	8,694	3.6
1942-43	300,695,000	230,285,000	76.6	9,921	3.0
1943-44	296,505,000	228,178,000	77.0	※	—

* Figures not available.

Sources: Department of Commerce, Bureau of Foreign and Domestic Commerce, published in Survey of Current Business, June 1943; p. 22.

Department of Commerce, Bureau of Census; Statistical Abstract of the United States, 1942; p. 358.

taxes has declined, the income has consistently increased which helps to explain the decline in percentage.

Importance of Revenue Sources at Different Periods

A good way of showing the changing situation in our revenue system supporting the General Fund is that shown in the following comparison. The sources of revenue for each year shown here are listed according to their importance in the revenue system from the standpoint of yield.

RECEIPTS IN ORDER OF IMPORTANCE— GENERAL FUND

1930-1931	1940-1941	1943-1944
1. Inheritance Tax	1. Corporate Net Income	1. Corporate Net Income
2. Capital Stock Taxes	2. Capital Stock	2. Capital Stock
3. Gross Receipts	3. Liquor Store Profits	3. Malt and Liquor
4. Institutional Reimbursements	4. Gasoline Tax	4. Inheritance Tax
5. Loans Taxes	5. Malt and Liquor	5. Cigarette Tax
6. Insurance Premium	6. Inheritance Tax	6. Liquor Store Profits ⁷
7. Business License	7. Cigarette Tax	7. Gasoline Tax

In the 1930-1931 fiscal year, the most important sources of revenue were the business taxes, with the inheritance tax on the top of the list. Within the ten-year period, a definite shift took place. The two top taxes were still business taxes, but the remaining five were sales taxes with the inclusion of the liquor store profits. In this period, the inheritance tax descended to sixth in importance. The year 1940-1941 was selected as a normal year, for this was when business was started on the upswing because of war orders from abroad. Then, for comparison, the 1943-1944 war year is taken. The corporate net income and capital stock taxes are still the largest producing taxes. The inheritance tax came up to fourth place while the gasoline tax went down to seventh place because of the wartime rationing of gasoline.

The greatest portion of our total receipts and revenues is

⁷ There was an amount of \$11,000,000 in profits above this amount which was not deposited in the General Fund. Had this amount been deposited, liquor store profits would have stood in third place again.

from business taxes which in 1943-1944 were 42.4% of the total. The increase in business taxes from the 1940-1941 fiscal year to 1943-1944 was 57%, while during the same period total taxes and revenues increased only 2%. The corporate net income tax, part of the business taxes, increased to 121% in the same period. The corporate net income tax yielded the greatest amount of revenue among the business taxes from 1937-1938. Before that the capital stock tax was first as to yield. Now the capital stock tax ranks second.

The Distribution of Corporate Net Income Tax and Capital Stock Tax Among Various Classes of Corporations

The share of the burden carried by the different classes of corporations in the corporate net income tax and the capital stock tax is shown in the tables which follow:

DISTRIBUTION OF THE CORPORATE NET INCOME TAX
AMONG THE VARIOUS CLASSES OF CORPORATIONS
1937-1941

<i>Type of Corporation</i>	<i>% of Corporate Net Income Tax Paid 1937</i>	<i>% of Corporate Net Income Tax Paid 1941</i>
Manufacturing	48.1%	64.9%
Mercantile	6.4	5.8
Brick, Clay, Slate	.6	.4
Water	1.8	.8
Telephone and Telegraph	4.7	2.6
Transportation	13.6	6.4
Electric Power and Light	12.9	9.1
Oil and Gas	2.9	1.9
Land and Improvement	.9	.7
Brewing	.7	.7
Distilling	.4	.1
Personal holding, investment, or loan companies	.2	.1
Other (miscellaneous)	5.6	4.6
Coal and Coke	1.2	2.0

Source: Statistical Study Committee of the Tax Advisory Committee.

DISTRIBUTION OF THE CAPITAL STOCK TAX AMONG THE
VARIOUS CLASSES OF CORPORATIONS
1937-1941

<i>Type of Corporation</i>	<i>% of Capital Stock Tax Paid 1937</i>	<i>% of Capital Stock Tax Paid 1941</i>
Manufacturing	41.1%	56.5%
Mercantile	4.2	4.9
Brick, Clay, Slate	.5	.4
Water	1.4	1.3
Telephone and Telegraph	3.7	3.4
Transportation	21.7	7.1
Electric light and power	12.2	11.6
Oil and Gas	2.9	2.7
Coal and Coke	3.8	3.4
Land and Improvement	1.8	1.7
Brewing	.4	.5
Distilling	.2	.1
Personal holding, investment, or loan companies	.3	.3
Other (miscellaneous)	5.8	6.1

Source: Statistical Study Committee of the Tax Advisory Committee.

The above tables show that manufacturing corporations have carried the greatest burden in the corporate net income tax and the capital stock tax. The percentage in both instances has increased, while the percentage that transportation and electric power and light corporations have had to pay has decreased.

Major Classes of Revenues for the Last Fourteen Years

In order to have a better understanding of the system under which the State receives revenues, a classification is given to serve that purpose. This classification shows receipts from major classes of receipts for the last fourteen years.

The greatest percentage changes occurred in business taxes, sales and excise taxes, inheritance taxes, and business licenses and fees. Business taxes increased from 25.7% of the total in 1930-1931 to 42.4% in 1943-1944. In the same period, sales and excise taxes increased from 15.3% to 29.9%; inheritance

TREND IN RECEIPTS
1930-31 TO 1943-44

<i>Year</i>	<i>Business Taxes</i>	<i>% of Total</i>	<i>Sales and Excise Taxes</i>	<i>% of Total</i>	<i>Tax on Indebtedness</i>	<i>% of Total</i>
1930-31	\$47,734,464	25.7	\$28,483,110	15.3	\$8,292,695	4.4
1931-32	40,958,127	26.0	28,146,849	17.9	7,540,304	4.8
1932-33	30,554,996	19.4	35,840,021	22.8	6,553,949	4.2
1933-34	27,391,518	19.5	33,778,239	24.0	7,943,228	5.7
1934-35	30,273,009	21.1	37,201,430	25.9	8,354,663	5.8
1935-36	44,703,062	23.1	71,434,852	36.9	5,144,951	2.7
1936-37	95,272,931	31.3	100,833,524	33.1	15,594,804	5.1
1937-38	82,364,550	29.3	91,832,666	32.6	10,668,041	3.8
1938-39	64,738,275	25.3	92,103,811	36.0	7,942,990	3.1
1939-40	72,842,618	26.9	92,803,965	34.3	10,450,701	3.9
1940-41	80,152,029	27.7	104,523,950	36.1	7,755,237	2.7
1941-42	100,377,523	32.5	109,853,036	35.5	7,962,261	2.6
1942-43	112,299,885	37.3	99,967,317	33.2	6,968,533	2.3
1943-44	125,846,902	42.4	88,543,443	29.9	7,141,984	2.4

TREND IN RECEIPTS—Continued

<i>Year</i>	<i>Inheritance Tax</i>	<i>% of Total</i>	<i>Business Licenses and Fees</i>	<i>% of Total</i>	<i>Fines, Penalties and Interest</i>	<i>% of Total</i>
1930-31	\$38,631,859	20.8	\$40,364,120	21.7	\$650,359	.3
1931-32	19,023,290	12.1	37,905,110	24.1	1,217,743	.8
1932-33	30,910,372	19.6	35,444,373	22.5	601,752	.4
1933-34	13,665,031	9.7	38,332,659	27.3	576,832	.4
1934-35	18,528,966	12.9	39,999,540	27.9	807,701	.6
1935-36	18,724,031	9.7	42,982,185	22.2	671,216	.3
1936-37	16,005,955	5.3	47,343,410	15.5	835,066	.3
1937-38	27,884,811	9.9	45,765,786	16.3	909,966	.3
1938-39	20,108,709	7.9	45,857,069	17.9	1,106,352	.4
1939-40	18,575,596	6.9	47,789,635	17.7	805,705	.3
1940-41	15,392,191	6.3	52,596,382	18.2	878,493	.3
1941-42	13,307,389	4.3	51,520,617	16.7	1,513,233	.5
1942-43	13,356,168	4.4	44,695,153	14.9	1,222,597	.4
1943-44	16,628,722	5.6	41,253,658	13.9	2,315,804	.8

TREND IN RECEIPTS—Continued

<i>Year</i>	<i>Miscellaneous Revenue</i>	<i>% of Total</i>	<i>Personal Property</i>	<i>% of Total</i>	<i>Institutional Reimburse- ments</i>	<i>% of Total</i>
1930-31	\$2,923,142	1.6	\$		\$8,428,106	4.5
1931-32	2,829,160	1.8			8,003,934	5.1
1932-33	2,175,695	1.4			7,346,470	4.7
1933-34	10,528,617	7.5			5,565,495	4.0
1934-35	1,085,085	.7			4,941,746	3.4
1935-36	941,523	.5	518,787	.3	6,060,309	3.1
1936-37	1,833,944	.6	17,794,516	5.8	6,195,332	2.0
1937-38	1,717,942	.6	11,919,750	4.2	5,559,095	2.0
1938-39	2,165,194	.9	12,095,283	4.7	5,162,396	2.0
1939-40	4,106,245	1.5	11,556,478	4.3	6,919,449	2.5
1940-41	2,166,361	.7	11,106,876	3.8	5,847,565	2.0
1941-42	3,081,015	1.0	9,959,562	3.2	6,596,744	2.1
1942-43	2,060,544	.7	9,190,793	3.1	5,468,957	1.8
1943-44	2,341,143	.8	427,074	.1	5,907,311	2.0

TREND IN RECEIPTS—Continued

<i>Year</i>	<i>Receipts Appropriated for Specific Purposes</i>	<i>% of Total</i>	<i>Construction and Maintenance Contributions</i>	<i>% of Total</i>	<i>Total Receipts</i>
1930-31	\$705,029	.4	\$10,031,905	5.4	\$186,083,795
1931-32	722,177	.4	11,038,431	7.0	157,385,130
1932-33	724,046	.5	7,094,365	4.5	157,246,043
1933-34	2,162,015	1.5	597,648	.4	140,541,288
1934-35	2,124,978	1.5	217,484	.2	143,537,872
1935-36	2,400,093	1.2	242,027	.1	193,823,040
1936-37	2,803,647	.9	232,230	.1	304,745,362
1937-38	2,623,516	1.0	320,009	.1	281,526,135
1938-39	3,893,898	1.5	622,076	.2	255,796,059
1939-40	4,095,595	1.5	541,102	.2	270,497,197
1940-41	7,907,374	2.7	1,500,594	.5	289,827,058
1941-42	3,696,426	1.2	1,242,471	.4	309,110,283
1942-43	4,187,418	1.5	1,277,239	.4	300,694,608
1943-44	5,495,617	1.9	603,291	.2	296,504,983

taxes decreased from 20.8% to 5.6% and business licenses and fees decreased from 21.7% to 13.9%. The remaining seven categories have remained almost stable throughout the fourteen-year period.

Since 1943-1944 is an abnormal year from the standpoint of the State's revenues, a better year for comparison is the more normal year of 1941-1942. In that year receipts from business taxes yielded 32.5% of total State revenues, sales and excise taxes 35.5%, inheritance taxes 4.3%, and business licenses and fees 16.7%. It is apparent that the emphasis in our State revenue system has been placed upon business taxes and sales and excise taxes. Together in 1941-1942, the receipts from these two groups of taxes were 68% of total receipts. The decline in inheritance taxes has been not so much in the total amount of receipts from inheritance taxes but rather the declining importance of such receipts has resulted from the increasing importance of the business and sales taxes.

This classification of receipts and the comparisons between the classes which it affords needs the careful study of the Legislature. In considering measures to foster employment in this State much consideration needs to be given to the heavy share of the tax burden which is placed on business one way or another. It will be one of the objectives of this Committee in its future work to secure information which will show whether this heavy share of the tax burden placed on business is hindering employment.

DESCRIPTION OF OUTSTANDING SOURCES OF REVENUE

In order to furnish a closer view of our revenue system a short description of the outstanding sources seems to be necessary. This short description which follows will aid in further study of the tax system.

1. *Business Taxes*

a. *Capital Stock Tax*

This is a property tax of 5 mills on the value of the capital stock of the Corporation after allowing all exemptions provided by law. The value of the capital stock is determined by giving consideration to all facts contained in the Capital Stock Tax Report. After due consideration of all facts, the value represents the judgment of the taxing officers of the Tax-

ing Departments and is not the result of any mathematical formula.

A proportioning fraction is applied to the valuation in cases where the corporation possesses assets exempt by law. This fraction consists of "Total Taxable Assets" in the numerator and "Total Assets" in the denominator. The exempt assets which are deducted from the total assets consist of tangible property located outside the Commonwealth, investment in shares of Pennsylvania corporations, investment in shares of foreign corporations over 50% owned, and investment in United States securities.

Prior to 1935, an exemption was allowed for all assets employed in manufacturing. The emergency legislation of 1935 eliminated this exemption. In the Act of 1943, it was provided that the manufacturing exemption shall become effective on the first day of the first calendar year after the cessation of hostilities in the present war.

b. *Franchise Tax*

This is a privilege tax of 5 mills on the value of the capital stock of the foreign corporation after applying the allocation fractions provided by law. The value of the capital stock is determined in the same manner as for the capital stock tax.

In order to determine the extent to which the value of the capital stock should be taxed, three fractions are applied:

- (1)
$$\frac{\text{Total Tangible Property in Pennsylvania}}{\text{Total Tangible Property Everywhere}}$$
- (2)
$$\frac{\text{Total Wages and Salaries in Pennsylvania}}{\text{Total Wages and Salaries Everywhere}}$$
- (3)
$$\frac{\text{Total Gross Receipts in Pennsylvania}}{\text{Total Gross Receipts Everywhere}}$$

Prior to 1935, foreign corporations were subject to the Capital Stock Tax Act in the same manner as domestic corporations.

c. *Corporate Net Income Tax*

This is an emergency tax which became effective in 1935 and is based on the privilege of doing business in Pennsylvania.

The same allocation fractions as set forth under "Franchise Tax" are applicable to the taxable income.

The basic income used for the determination of this tax is the income reported to the Federal Government. During the years 1935 to 1942 inclusive, a deduction was permitted for "Dividends Received" and "Federal Taxes" and the rates of tax were 1935, 5%; 1936, 10%; 1937 to 1942 inclusive, 7%. Effective in the calendar year 1943 and fiscal years beginning in 1943, no deduction is allowed for "Federal Taxes" and the rate was reduced to 4%. As far as has been determined this change has not resulted in a total tax increase, Federal and State, of more than $\frac{1}{2}\%$ to any corporation. The change has resulted in a decrease in total Federal and State taxes of 2% to 3% for corporations of small or medium incomes.

d. *Bonus—Domestic and Foreign*

Domestic corporations pay a bonus of $\frac{1}{5}\%$ on the total amount of authorized capital stock.

Foreign corporations pay a bonus of $\frac{1}{3}\%$ on the greatest amount of capital employed in Pennsylvania at any one time during the period. After bonus has once been paid on a given amount, the assessment in subsequent years is made on the increase over the greatest amount of capital previously employed in Pennsylvania.

e. *Shares Tax*

This tax is imposed upon State banks, National banks, savings institutions without capital stock, title insurance companies, trust companies and companies having both banking and trust company powers.

The tax is levied on the value of the outstanding shares of stock and determined by the actual value of assets as of December 31.

Prior to 1936, the rate of shares tax on State and National Banks was 4 mills and title insurance and trust companies was 5 mills. In 1936, an emergency measure increased the rates to 8 mills which was effective through 1942. In 1943, the emergency tax was dropped and the rate reverted to 4 mills and 5 mills as prior to 1936.

f. *Insurance Premiums Tax*

This is an 8 mills tax imposed on the gross premiums of domestic companies on risks located in Pennsylvania. Foreign

companies authorized to do business in Pennsylvania are taxed 2 per cent on gross premiums on risks located in Pennsylvania except where the State of incorporation imposes a higher rate, in which case we use the latter. In cases where insurance, on risks located in Pennsylvania, is purchased by residents of Pennsylvania from an insurance company not authorized to do business in this Commonwealth, the insured is obligated to deduct the 2 per cent tax from his premium payment and remit the tax to the Commonwealth.

g. *Net Earnings Tax on Savings Institutions*

An excise tax of 3 per cent is imposed upon the net earnings of savings institutions without capital stock.

h. *Gross Receipts Tax*

The gross receipts of corporations engaged in the sale of transportation and communication services and of electrical energy were subject to a tax of 8 mills prior to 1935. From 1935 to June 30, 1936, the rate was increased to 14 mills. From July 1, 1936, to 1943, inclusive, the rate was increased to 20 mills. In 1944 the rate was decreased to 14 mills.

The gross receipts of all operators of motor vehicles for hire is taxed 8 mills.

The gross receipts of private banks is taxed 1 per cent.

2. *Sales and Excise Taxes*

a. *Stock Transfer Stamp Tax*

A tax of two cents on each one hundred dollars of the face value or fraction thereof is imposed on transfers of shares of stock in any domestic or foreign corporation, copartnership, association, or joint stock company or upon sales agreements or memoranda sales of stock of such organizations. In cases where no value is designated, the tax is imposed at the rate of two cents per share.

b. *Liquor Sales Tax and Liquor Store Profits*

A sales tax of one-half per cent per pint is imposed on beers and wines. An emergency sales tax of ten per cent of the net selling price is imposed on all liquor.

The profits realized from the operation of the State Liquor Stores by the Liquor Control Board is turned over to the General Fund.

c. *Cigarette Tax*

A sales tax of one cent per ten cigarettes was imposed as an emergency measure and is still in effect.

d. *Liquid Fuels Tax*

A sales tax of four cents per gallon is imposed on the sale of gasoline of which one cent per gallon is an emergency measure and is deposited in the General Fund.

e. *Tax on Writs, Wills and Deeds*

This is imposed on the issuance of legal documents and the recording of deeds at specified rates for each type of transaction.

3. *Tax on Indebtedness*

This tax is referred to as the corporate loans, municipal loans and School District loans taxes. The tax is imposed upon certain holders of the indebtedness of corporations, municipalities, or school districts. However, the law designates the latter as collectors of the tax and provides that they shall be entitled to a commission based on the amount of tax collected.

Loans tax is imposed on holders of indebtedness who are individual residents of Pennsylvania, private banks, savings institutions without capital stock and trustees who are holding such indebtedness in trust for any of the above owners and non-residents whose ownership results from the creation of any estate by a Pennsylvania decedent.

The original rate of loans tax was four mills and was effective through 1935. In 1936 and 1937 the rate was increased to 5 mills and 8 mills respectively. The additional tax was an emergency measure. Effective in 1944 and fiscal years beginning in 1944, the emergency measure is eliminated and the rate reverts to four mills.

4. *Inheritance Taxes*

A tax of two per cent to direct heirs and ten per cent to collateral heirs including charities is imposed upon the actual value of estates at the time of death.

5. *Business Licenses and Fees* (including Motor Licenses)

Licenses and fees are collected for the privilege of carrying on various types of business and professions and for the operation of motor vehicles.

6. *Fines and Penalties.*

Revenue from this source is a result of violations of laws.

OPERATION OF THE TAX SYSTEM

It was hoped that this Commission could set forth information which would show how the system of taxation in Pennsylvania is operating. There are a number of questions about the operation of the system which should be known. Some of them are as follows:

What is the relative burden imposed upon the various classes of business by the tax system?

What is the incidence of our major taxes?

To what extent do our taxes accord with ability to pay?

To what extent does the system of taxation decrease employment and discourage investment and private enterprise?

These are some of the important questions which arise in examining the operation of the tax system. But time has not permitted sufficient research and study to assemble the necessary information for arriving at conclusions. During the past year a great deal of study of the system of taxation has been done under the auspices of the Joint State-Government Commission and those studies are continuing. It may be that information on the questions mentioned above can be obtained from the future studies of that Commission. The examination of the operation of the tax system constitutes an important future program for the Commission.

FINDINGS AND RECOMMENDATIONS

FISCAL POLICY

1. At the end of the present biennium, May 31, 1945, there will be \$61,000,000 surplus funds available in the General Fund for post-war work and \$55,000,000 in the Motor License Fund. In succeeding biennia these funds can be supplemented by about \$10,000,000 from the General Fund and \$45,000,000 in a normal year from the Motor License Fund.

2. Due to the fact that the present General Fund tax structure yields revenues above anticipated appropriations some reduction of the taxes supporting the General Fund should be made.

This recommendation is stated in this manner because there is a spread of about \$22,000,000 between estimated General Fund receipts and anticipated appropriations. In the Governor's Budget Message he has recommended that the one-cent liquid fuels tax be dropped as a General Fund tax and be transferred to the Motor License Fund. He has recommended therefor a reduction in General Fund receipts of \$22,500,000 in a two-year period.

3. While the State's indebtedness is low it would be good policy to use some of the surplus for reducing indebtedness. The General State Authority bonds should be paid off because of the high interest rate and because the present State Authority-State arrangement causes administrative difficulties.

4. Because of the time lag of more than two years for the State to borrow above the constitutional limit of \$1,000,000, it appears that it would be advisable for the Legislature to consider whether the borrowing provision of the Constitution should be changed either to increase the amount which may be borrowed by the Legislature or to shorten the period of borrowing.

5. An examination of State expenditures for public works during the last twenty-three years shows that the State has followed the policy of undertaking large public works programs in prosperous years and small programs in years of business depression. The State could better promote the economic welfare of the State by reversing such policy and co-ordinating the public works program with the business cycle.

Due to the great uncertainty of post-war years, the State should set up a public works program of essential projects and, excepting urgent projects which should be undertaken as soon as possible, this program should be developed in co-ordination with existing economic conditions.

6. It appears that due to financial stringency and to war conditions the State has fallen behind in providing for its capital facilities. For that reason there is a large program of urgent projects. From surplus funds now on hand and from funds with which these surplus funds can be supplemented in future years these urgent projects should be undertaken as soon as conditions will permit.

7. Most of the State's expenditures are made for health and welfare, public education, and highway purposes. The size of the expenditures for these purposes depends in large measure upon the extent to which the State takes over functions from local governments.

8. Transfers of expenditures from one jurisdiction to another should be made only when absolutely necessary since it is believed increased governmental costs result from this situation. This situation arises between the States and local governments and the Federal Government and the States. However, it should be recognized that although State expenditures have greatly increased in assuming and financing functions formerly performed and financed locally, local expenditures have increased at the same time. Rather than a further transfer of functions to the State it seems that the Legislature might well consider establishing a more helpful system of sharing revenues between State and local governments.

STATE TAXATION

1. General Fund receipts in the 1943-1944 fiscal year were nearly three times that of ten years ago. Before enlarging the tax system an examination of the relationship between State revenues and the income of the State should be made. Otherwise the enlargement of the tax structure might be harmful to the economic system from which State revenues are derived.

2. The rapid enlargement of the tax structure in Pennsylvania included taxes on business and selected sales taxes primarily. Because of the high percentage of the revenues of the State that are derived from taxes on business corporations, there should be a careful study made to determine whether this burden is having harmful effects from the standpoint of discouraging investment, business enterprise, and causing less employment.

3. Since there is a margin between receipts from the present tax structure and expenditures the recommendation is made that the emergency one-cent tax on liquid fuels be abolished as a General Fund tax. If re-enacted the receipts should be placed in the Motor License Fund and distributed to local governments for highway and street improvement. One of the chief reasons for this recommendation is that this would be a means of enabling local governments to reduce real property taxes.

4. It is evident that while there is a State tax on corporations based on income there is no personal tax based on income. If levied, such a tax, due to the constitutional requirement of uniformity, would have to be a flat rate tax as is the corporate income tax. Due to the fact there is no personal income tax the share of the burden which such a tax would carry has been shifted to other forms of taxation—partly to business taxation and selected sales taxes it appears.

5. A careful study of personal income taxation should be made to discover its advantages and disadvantages to determine whether the Pennsylvania tax structure would be improved by the enactment of such a tax. The study should go into the question of whether the constitutional provision should be changed which has been interpreted to prohibit an exemption for the low income brackets.

6. A careful study of sales taxes should be made for the same purposes as mentioned in the above recommendation, namely, to ascertain its advantages and disadvantages.

7. In order to know more about the effects being produced by our system of taxation a major study should be set up for that purpose. Some of the lines of inquiry in such a study should be:

What is the relative burden imposed upon the various classes of business by the tax system?

What is the incidence of our major taxes?

To what extent do our taxes accord with ability to pay?

To what extent does the system of taxation decrease employment and discourage investment and private enterprise?



